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No. —

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1983

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HENRY C. TILFORD, JR. and BARBARA N. TILFORD,  
*Petitioners*  
v.  
COMMISSIONER OF INTERNAL REVENUE,  
*Respondent*

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PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SIXTH CIRCUIT

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H. WAYNE GRANT  
(Counsel of Record)  
JOHN P. KONVALINKA  
GRANT, KONVALINKA &  
GRUBBS, P.C.  
600 Tallan Building  
Chattanooga, Tennessee 37402-2502  
615/756-8232

W. WAYNE DRINKWATER, JR.  
LAKE, TINDALL, HUNGER  
& THACKSTON  
127 South Poplar Street  
P. O. Box 918  
Greenville, Mississippi 38701  
601/378-2121

## QUESTIONS PRESENTED

1. Whether Treasury Regulation § 1.83-6(d) (1978), which defines the tax consequences to shareholders of transfers of their property to corporate employees in connection with restricted stock plans, reasonably promotes the purpose of section 83 of the Internal Revenue Code, which does not mention such shareholders and which deals solely with the tax consequences of such transfers to the recipient-employees and their employers; whether language in the Senate Finance Committee Report on which the Regulation is based goes beyond section 83, rendering it infirm as support for the Regulation.

2. Whether Treasury Regulation § 1.83-6(d) (1978) is inconsistent with section 1001(c) [formerly section 1002] of the Internal Revenue Code to the extent that the Regulation purports to treat such property transfers by shareholders as contributions to the capital of the corporation rather than as sales or exchanges of property on which gain or loss is recognized.

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**OPINIONS BELOW**

The opinion of the Tax Court is reported at 75 T.C. 134. The opinion of the United States Court of Appeals for the Sixth Circuit is reported at 705 F.2d 828.

**STATEMENT OF JURISDICTION**

The judgment of the United States Court of Appeals for the Sixth Circuit was made and entered on April 20, 1983. Petitioners' motion for rehearing and rehearing *en banc* was denied in an order entered on May 27, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

**STATUTES AND REGULATIONS**

26 U.S.C. § 83

26 U.S.C. § 1001(c)

Treasury Regulation § 1.83-6(d) (1978)

The full text of the cited statutes and regulation is found at Appendix C.

## STATEMENT OF THE CASE

A restricted stock plan is an arrangement in which stock, either of the employer corporation or other companies, is transferred to employees at bargain prices, subject to restrictions which affect its value. Such restrictions commonly require the return or resale of the stock if the employee leaves the employer before expiration of a stated employment term. Restricted stock plans are forms of deferred compensation that have become increasingly widespread in recent years.

Until 1969, the Internal Revenue Service imposed no tax on the recipient-employee at the time he received the restricted stock. Tax was deferred until the restrictions lapsed, and then imposed only on the value of the stock as of its date of transfer, without regard to any increase in value in the interim; moreover, if the stock value had declined at the time the restrictions lapsed, the lower value was regarded as the amount of compensation. This treatment gave restricted stock plans important advantages over other deferred compensation arrangements.

By 1969, the increasing popularity of restricted stock plans caused Congress to tighten this favorable tax treatment. In section 321 of the Tax Reform Act of 1969, now codified as section 83 of the Internal Revenue Code, Congress dealt with the tax consequences of transfers of property made in connection with the performance of services, particularly including restricted stock plans. The primary aim of section 83 was to accelerate and enhance the taxability of such transfers by defining those amounts includable in gross income of the recipient-employee and by determining the timing of such income inclusion. "In general, section 83 provides that property received for the performance of services is to be included in the income of the recipient (at its fair market value);

however, if the property is not freely transferable by the recipient, or is subject to forfeiture, the value of the property is determined and taken into income only upon the termination of such restrictions." *Tilford v. Commissioner*, 75 T.C. 134, 143 (1980).

Although section 83 was an income-defining measure in primary purpose and effect, section 83(h) dealt with deductions, continuing the former practice of granting a business expense deduction to the employer to correspond with the income required to be reported by the recipient-employee.

Stock used in restricted stock plans may be provided by the employer, or the stock may be transferred to the employees by shareholders of a corporate employer. Nowhere does section 83 address the tax consequences of such transfers to such third-party shareholders who may provide the stock used in a restricted stock plan. Such transfers have long been governed by section 1001(c) [formerly section 1002] of the Internal Revenue Code, which recognizes gains or losses to the shareholder in connection with any such sale or exchange of property.

But although Congress did not seek to address in section 83 the tax consequences of such stock transfers by shareholders, or undertake to affect the longstanding applicability to them in section 1001(c), the Senate Finance Committee included the following language in its Committee Report on the Tax Reform Act of 1969:

In general, where a parent company's or a shareholder's stock is used to compensate employees under a restricted stock plan, the transfer of the stock by the parent company or shareholder is to be treated as a capital contribution to the company which is to be entitled to a deduction in accordance with the restricted property rules. The parent company or the shareholder merely is to reflect the contribution as an increase of the equity in the company which is entitled to the compensation deduction.

Tax Reform Act of 1969, S. Rep. No. 552, 91st Cong., 1st Sess. 123-24, 1969 U.S. Code Cong. & Ad. News 2027, 2155.

Nine years later, the Internal Revenue Service adopted 26 C.F.R. § 1.83-6(d) (1978), which, based on the language of the Senate Committee Report, undertook to preclude the established application of section 1001(c) to shareholder stock transfers by characterizing the transfers as contributions to capital of the employer corporation:

(d) *Special rules for transfers by shareholders*—(1) *Transfers*. If a shareholder of a corporation transfers property to an employee of such corporation or to an independent contractor (or to a beneficiary thereof), in consideration of services performed for the corporation, the transaction shall be considered to be a contribution of such property to the capital of such corporation by the shareholder, and immediately thereafter a transfer of such property by the corporation to the employee or independent contractor under paragraphs (a) and (b) of this section. For purposes of this (1), such a transfer will be considered to be in consideration for services performed for the corporation if either the property transferred is substantially nonvested at the time of transfer or an amount is includable in the gross income of the employee or independent contractor at the time of transfer under § 1.83-1(a)(1) or § 1.83-2(a). In the case of such a transfer, any money or other property paid to the shareholder for such stock shall be considered to be paid to the corporation and transferred immediately thereafter by the corporation to the shareholder as a distribution to which section 302 applies.

Treasury Regulation § 1.83-6(d) (1978).

This taxpayer's suit arises out of the Commissioner of Internal Revenue's disallowance of a deduction claimed by petitioner Henry C. Tilford, Jr. pursuant to section 1001(c) on losses on transfers of stock in a closely held

corporation in the years 1971 through 1973. The basis for the disallowance was Treasury Regulation § 1.83-6(d).

Tilford has a sign business, incorporated in 1969 as Watco, Inc., a Tennessee corporation. As of December 31, 1970, Tilford had invested \$350,000.00 in Watco stock, owning all of the company's shares, and had loaned the company an additional \$79,500.00. Watco consistently lost money, and Tilford, without significant experience in the sign industry, solicited experienced personnel in an effort to turn the company around.

To give key employees a stake in the future outcome of the business, Tilford sold them substantial blocks of his Watco stock at nominal prices which accurately reflected the company's lack of market value at the time. By contract, Tilford retained the first right of refusal to repurchase the stock so transferred, if the recipient-employee ever wished to sell or for any reason left Watco's employment. In 1971-73, Tilford claimed losses that reflected the difference between his basis in the transferred Watco stock and the nominal amounts he received from the recipient-employees.

The Commissioner disallowed the deductions, concluding that the stock transfers were contributions to the capital of Watco by Tilford. The basis for the disallowance is Treasury Regulation § 1.83-6(d), which became finally effective in 1978, years after Tilford's claimed deductions, and subsequent to the commencement of this litigation. The Tax Court<sup>1</sup> allowed the claimed deductions, holding that Treasury Regulation § 1.83-6(d) was invalid because it lay "outside the scope of the statutory provisions of section 83[.]" 75 T.C. at 145, a section the Tax Court found to be "an income-defining section, en-

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<sup>1</sup> The Tax Court's jurisdiction was properly invoked under 26 U.S.C. § 6213(a). This case was heard before the Honorable Leo H. Irwin and was considered significant enough to be reviewed by the Tax Court pursuant to 26 U.S.C. § 7460(b).

acted primarily to deal with the recognition of income under certain restricted stock compensation plans." 75 T.C. at 144. The Tax Court found nothing in the plain language of section 83 to support a conclusion that Congress had intended to remove bona fide sales or exchanges of stock from the treatment provided by section 1001(c). The Tax Court was unimpressed by the Senate Committee Report, noting that "the committee report is not the statute, and to the extent that its language goes beyond the legislation then being enacted or theretofore existing statutory provisions (*i.e.*, section 1002), it certainly cannot serve as support for a regulation suffering the same infirmity." 75 T.C. at 146.

On appeal, a divided Court of Appeals for the Sixth Circuit reversed, upholding Treasury Regulation § 1.83-6(d) as consistent with the legislative history of section 83 expressed in the above-quoted portion of the Senate Committee Report. A timely petition for rehearing and rehearing *en banc* was denied, and this petition for certiorari followed.

### REASONS FOR GRANTING THE WRIT

This case draws into serious question the validity of an important Treasury Regulation not previously considered by this Court. Moreover, the judgment below raises significant issues concerning the use of congressional committee reports to legislate matters neither addressed nor suggested by the statutes to which they pertain.

1. The Commissioner's disallowance of Tilford's claimed deduction is based solely on Treasury Regulation § 1.83-6(d), which must be reasonably related to the purpose of section 83, the statute from which the Regulation derives. *United States v. Cartwright*, 411 U.S. 546, 550 (1973).<sup>2</sup> But section 83 has nothing to do with the

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<sup>2</sup> Interestingly, Treasury Regulation § 1.83-6(d) was finally adopted only after this case had been tried and briefed in the Tax Court. Although the Secretary of the Treasury has power to adopt

tax consequences to third-party shareholders who sell or exchange property in connection with restricted stock compensation plans; that section undertakes to define such consequences only for the recipients of the transferred stock and for persons for whom the recipient-employees performed services. Section 83 nowhere purports to deny a deduction to third-party shareholders who provide the stock for restricted stock plans. Because it goes far beyond the plain language of section 83(h) and legislates with respect to matters not included in the statute's scope, Treasury Regulation § 1.83-6(d) is invalid.

The Regulation further contradicts section 1001(c), in which Congress specifically provided for recognition of a gain or loss upon the sale or exchange of property such as the Watco stock here involved.<sup>3</sup> By forcing such transfers to be treated as contributions to capital, Treasury Regulation § 1.83-6(d) defeats the congressional purpose expressed in section 1001(c). The inconsistency of the

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regulations with retroactive effect, that power is subject to an abuse-of-discretion review. The Secretary's exercise of his discretion is properly regarded with some skepticism when the regulation with which the Commissioner seeks to support his disallowance of a deduction was adopted both after the disallowance decision was made and after litigation challenging that decision was commenced. See *Chock Full O'Nuts Corp. v. United States*, 453 F.2d 300, 303 (2d Cir. 1971) ("the Commissioner may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations.")

<sup>3</sup> The Commissioner has not seriously contended that the transactions between Tilford and Watco employees were not sales or exchanges of property otherwise within the scope of section 1001(c). See *Commissioner v. Brown*, 380 U.S. 563, 570-71 (1965). The claim is rather that section 83(h) and Treasury Regulation § 1.83-6(d) preclude the application of section 1001(c) to such transactions. Even if Tilford's actions were motivated in part by a desire to reduce his taxes, rather than solely by concern for Watco, that is of course no reason why section 1001(c) could not apply. See *Gregory v. Helvering*, 293 U.S. 465 (1935).



Regulation with section 1001(c) is ample reason to invalidate the Regulation. *United States v. Cartwright*, 411 U.S. 546, 557 (1973).

The Regulation also obliterates the necessary distinction between a shareholder's contribution to a corporation which does not affect his ownership interest in the corporation, and a stock transfer which reduces that ownership interest. In the former situation, the transfer increases the shareholder's basis in his stock, and is therefore properly regarded as a contribution to capital; in the latter circumstance, the transfer, as a *non pro rata* surrender of stock, reduces the shareholder's interest in the corporation and may give rise to a deductible loss rather than a contribution to capital. This view has been generally accepted, *Downer v. Commissioner*, 48 T.C. 86 (1967); *Sack v. Commissioner*, 33 T.C. 805 (1960), *Estate of Foster v. Commissioner*, 9 T.C. 930 (1947); *Peabody Coal Co. v. United States*, 8 F. Supp. 845 (Ct.Cl. 1934); *Miller v. Commissioner*, 45 B.T.A. 292 (1941), *acquiesced* 1941-2 C.B. 9, *acquiescence withdrawn and nonacquiescence substituted* 1977-1 C.B. 2; *Wright v. Commissioner*, 18 B.T.A. 471 (1929), and its disregard by the Regulation constitutes an independent reason warranting this Court's attention.

Treasury Regulation § 1.83-6(d) and the result below have important consequences. Restricted stock plans constitute an increasingly prevalent and useful means of granting deferred compensation to corporate employees. The ability to make the full benefits of such stock transfers contingent upon the recipient-employee's continued tenure in the corporation makes the plans attractive to employers. Restricted stock plans can be important contributors to business stability and employee incentive. Transfers of stock from existing shareholders to corporate employees are a common method of executing restricted stock plans, particularly in the case of professional and closely held corporations. In these cases, application of



Treasury Regulation § 1.83-6(d) may impede restricted stock plans and produce anomalous tax consequences.

Clearly, shareholders will be reluctant to convey stock under circumstances which will cause an economic loss to them if they are deprived of the benefits of a deduction. Moreover, stock transfers may be made by shareholders to employees for reduced consideration, but under circumstances in which a capital gain would be realized by the shareholder, whose basis in the stock may be low. Application of Treasury Regulation § 1.83-6(d) would permit the shareholder to avoid or defer taxation of this gain. Congress cannot have intended, in section 83, to create a tax shelter for private investors.

2. Without support in the language of section 83, Treasury Regulation § 1.83-6(d) is derived exclusively from the previously-quoted language in the Senate Finance Committee Report. 1969 U.S. Code Cong. & Ad. News 2027, 2155; *supra* at 3. That the Regulation is faithful to this language cannot be doubted. But it also cannot be doubted that nothing in section 83 provides any basis for the Senate Committee Report.

There is no ambiguity in the treatment section 83 affords third-party shareholders who provide the stock used in restricted stock plans. The statute does not purport to affect them. Because no ambiguity exists in the scope of section 83, the Court of Appeals was wrong to consult legislative history indicating a contrary congressional intent, *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 184 n.29 (1978); *Ex parte Collett*, 337 U.S. 55, 61 (1949); *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85, 89 (1935), which in any event cannot contradict the statute's conclusive effect. See *Howe v. Smith*, 452 U.S. 473 (1981); *United States v. Shreveport Grain & Elevator Co.*, 287 U.S. 77, 83-84 (1932); *United States v. Missouri Pacific Railroad Co.*, 278 U.S. 269, 277-78 (1929).

The inclusion of language in congressional committee reports that is at odds with the plain language of the statute is not a phenomenon unique to this case. In *Hart v. United States*, 585 F.2d 1025 (Ct. Cl. 1978), the Court of Claims was confronted with such language in both the House and Senate Committee Reports to a 1960 tax bill. The Court's reaction was correct:

The first and most obvious comment is that these statements contradict the plain language of the statute they purport to relate to. It seems obvious that, under the Constitution, Congress must legislate in bills enacted in proper form and presented to the President for signature. To legislate by committee report would raise a constitutional problem at least as serious as the current one about the one-house veto. For such a contradictory report to have weight, therefore, we believe that even though contradictory, it must afford persuasive indication on its face that its authors believed they were fairly construing the statute as enacted, not amplifying, amending, or correcting it.

585 F.2d at 1030.

To be sure, not all statutes offer plenary solutions to the problems they address. In those instances where statutes are ambiguous, resort to legislative history is sometimes needed to determine congressional intent. Administrative regulations, when necessary and authorized by the Congress, fill in the spaces that statutes do not reach. But as this Court has often recognized, a committee report is not the statute, and an administrative agency is not the Congress. Just as the Presentment Clauses and the bicameral requirement, as aspects of our separation of powers, limited the power of Congress to act through the one-house veto, *Immigration and Naturalization Service v. Chadha*, 51 U.S.L. Week 4907 (June 21, 1983), the constitutional system requires the tax laws to be passed by the Congress, not its committees, and to be presented to the President for approval. When a committee report

undertakes to speak on a subject on which the statute is wholly silent, and when courts give effect to that language without regard to the plain terms of the statute, the constitutional scheme is subverted.

It is impossible to review this case without being left with the view expressed by Judge Nichols in dissent below:

[T]he Finance Committee wanted very much for the stockholder to be required for tax purposes to treat as a capital contribution to the corporation the stock he distributed to employees to retain them in corporate employ. The only trouble is the Committee failed to embody its wishes in an enacted bill. If this failure is not decisive of the case before us, the Committee is potent indeed.

705 F.2d at 832.

### CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

H. WAYNE GRANT

(Counsel of Record)

JOHN P. KONVALINKA

GRANT, KONVALINKA &

GRUBBS, P.C.

600 Tallan Building

Chattanooga, Tennessee 37402-2502

615/756-8232

W. WAYNE DRINKWATER, JR.

LAKE, TINDALL, HUNGER

& THACKSTON

127 South Poplar Street

P. O. Box 918

Greenville, Mississippi 38701

601/378-2121

## **APPENDICES**

**APPENDIX A**

**UNITED STATES COURT OF APPEALS  
FOR THE SIXTH CIRCUIT**

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No. 81-1447

HENRY C. TILFORD, JR. and BARBARA N. TILFORD,  
*Petitioners-Appellees,*

v.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent-Appellant.*

Appeal from the Decision of the  
United States Tax Court

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Decided and Filed April 20, 1983

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Before: EDWARDS, Chief Circuit Judge, JONES, Circuit Judge and NICHOLS,\* Circuit Judge.

EDWARDS, Chief Circuit Judge, delivered the opinion of the court and was joined by JONES, Circuit Judge. NICHOLS, Circuit Judge, (pp. 7-10) delivered a separate dissenting opinion.

EDWARDS, Chief Circuit Judge. This is an appeal by the Commissioner of the Internal Revenue Service from

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\* Judge Nichols was an Associate Judge of the United States Court of Claims when this case was argued. He was sitting by designation. On October 1, 1982, he became a member of the newly created United States Court of Appeals for the Federal Circuit, with the title of Circuit Judge, by various provisions of Pub. L. No. 97-164.

a Tax Court decision that held an IRS regulation invalid and by so doing, permitted the taxpayer to take substantial capital loss deductions.

The facts indicate that taxpayer Henry Tilford was the principal officer and shareholder of a company called Watco. He had invested \$350,000 in the company stock, thereby owning all of Watco's 170,000 issued shares, and had advanced an additional \$79,500 in loans by the end of 1970. Seeking to motivate a number of employees, he "sold" approximately 133,000 of these shares to said employees, each block of stock being priced at \$1.00 but with an agreement by which he reserved the right of first refusal to himself to repurchase the stock at book value in the event the employee concerned left Watco employment. The company failed and plaintiff, as employees left, repurchased the stock which had been issued to them.

In his personal tax returns for the years 1971, 1972 and 1973, Tilford claimed losses from the original sales of stock. He took deductions in amounts of \$370,992, \$150,497 and \$159,246, respectively for those years.

The Revenue Service disallowed these deductions claiming they were transfers of property in connection with the performance of services and hence contributions to Watco's capital under section 83 of the Internal Revenue Code. The Tax Court reversed and found for the taxpayer. It reasoned that the treasury regulation on which IRS relied is outside the scope of section 83 and held that Tilford was entitled to his claimed capital loss deductions. Six Tax Court judges dissented. The Revenue Service appeals to this court.

The case involves consideration of a Tax Court case upon which the majority of the Tax Court relied, *Downer v. Commissioner*, 48 T.C. 86 (1967), and another Tax Court decision *Smith v. Commissioner*, 66 T.C. 622 (1976). The *Smith* case was subsequently reversed by the Fifth Circuit under the name *Schleppy v. Commissioner*, 601 F.2d 196 (1979), with Judge Tuttle writing for the court. See

also *Deputy v. Dupont*, 308 U.S. 488 (1940), and *Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943).

The applicable subsection of the IRS Code is section 83(h):

**(h) Deduction by employer.**—In the case of a transfer of property to which this section applies or a cancellation of a restriction described in subsection (d), there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a), (b), or (d) (2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

We note at the outset that section 83(h) was adopted by Congress in 1969 after the decision of the *Downer* case and with apparent intention on the part of the Congress to embrace a theory contrary to the one underlying the *Downer* case.

The Internal Revenue Service, after Congress adopted section 83(h), interpreted it and the congressional intent in enacting it by adopting 26 C.F.R. § 1.83-6(d). This regulation reads:

**(d) Special rules for transfers by shareholders.—**

**(1) Transfers.** If a shareholder of a corporation transfers property to an employee of such corporation or to an independent contractor (or to a beneficiary thereof), in consideration of services performed for the corporation, the transaction shall be considered to be a contribution of such property to the capital of such corporation by the shareholder, and immediately thereafter a transfer of such prop-

erty by the corporation to the employee or independent contractor under paragraphs (a) and (b) of this section. For purposes of this (1), such a transfer will be considered to be in consideration for services performed for the corporation if either the property transferred is substantially nonvested at the time of transfer or an amount is includible in the gross income of the employee or independent contractor at the time of transfer under § 1.83-1(a)(1) or § 1.83-2(a). In the case of such a transfer, any money or other property paid to the shareholder for such stock shall be considered to be paid to the corporation and transferred immediately thereafter by the corporation to the shareholder as a distribution to which section 302 applies.

Treas. Reg. § 1.83-6(d) (1978).

This regulation appears to us to be consistent with both the legislative history and statutory intent of section 83(h).

The report of the Senate Finance Committee which added section 83(h) to the bill which had already passed the House explained:

In general, where a parent company's or a shareholder's stock is used to compensate employees under a restricted stock plan, the transfer of the stock by the parent company or shareholder is to be treated as a capital contribution to the company which is to be entitled to a deduction in accordance with the restricted property rules. The parent company or the shareholder merely is to reflect the contribution as an increase of the equity in the company which is entitled to the compensation deduction.

Tax Reform Act of 1969, S. Rep. No. 91-552, 91st Cong., 1st Sess. at 123-24, 1969-3 Cum. Bull. 500, 502.

This language is entirely consistent with much earlier tax law interpretation written by the Supreme Court of



the United States in *Deputy v. Dupont*, 308 U.S. 488 (1940) and *Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943). Both cases held that payments made by a stockholder for the benefit of his corporation are not deductible by the stockholder.

Judge Simpson's interpretation of the statute and the regulation in his dissent (joined by three other judges) is, we think, illustrative of the legislative purpose:

Usually, when we have a vexing question of statutory interpretation, we are faced with a problem not anticipated during the development of the legislation, and we are unable to ascertain the treatment which Congress would have intended if it had considered the matter. Not so in this case. Here, the legislative purpose is indisputable, and the regulations undertake to carry out that purpose. The majority quibbles with the way Congress undertook to express its purpose, and because it did not set forth all the intended rules in the statute itself, the majority proposes to disregard the clearly manifested legislative purpose.

When Congress decided to legislate with respect to the tax treatment of bargain sales of property to persons rendering services, it recognized that in addition to sales by an employer to an employee, it needed to provide rules broad enough to cover other compensatory sales of property. Thus, section 83(a), which governs the taxability of the recipient of the property, applies "If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed." Thus, the rule applies to any compensatory transfer, not merely to a transfer to an employee. It includes a sale made by a parent or shareholder of the employer corporation to an employee of such corporation.

By describing the recipient of the deduction as "the person for whom were performed the services," it is clear that Congress had in mind situations where the transferor would be a person other than the employer; there would have been no need to use such convoluted language if Congress had meant merely to cover a bargain sale by an employer to an employee. The committee report reinforces that view. S.Rept. 91-552 (1969), 1969-3 C.B. 423, 500-502.

In deciding whether a deduction is to be allowable in such situation, and to whom, the draftsmen no doubt had in mind the various views of the transaction that could be taken: when a shareholder sells his stock to an employee of the corporation, it could be viewed as a simple sale (*Downer v. Commissioner*, 48 T.C. 86 (1967)); under that view, there would be a capital transaction giving rise to gain or loss, but there would be no transfer of compensation taxable to the employee and deductible by either the transferor or the employer. *Deputy v. du Pont*, *supra*. In the alternative, the transaction could be viewed as a transfer of stock to the corporation and a transfer of such stock by the corporation to the employee. Since the statute allows a deduction for compensation, the statute makes clear that Congress rejected the view that the transaction was merely a sale by a shareholder to an employee.

Having decided to tax the employee on the receipt of compensation and to allow the corporation a deduction for that payment thereof, the draftsmen went on to explain in the committee report the theory on which such treatment was based; that is, the parent or shareholder is considered to have made a contribution to the capital of the corporation.

*Tilford v. Commissioner*, 75 T.C. 134, 154-56 (1980) (Simpson, J., dissenting).

For the reasons set forth above and further explicated by Judge Tuttle in *Schleppy v. Commissioner*, *supra*, we

hold that the majority opinion of the Tax Court in this case is erroneous as a matter of law and hence must be reversed.

NICHOLS, Circuit Judge, dissenting:

Respectfully, I dissent. I appreciate we have a difficult question. A treasury regulation is entitled to judicial deference unless it clearly misconstrues the statute it ostensibly interprets. I have respect for the Tax Court dissenters as well as the majority there and here, but I think the dissenters and our panel overlook a vital consideration which was obviously much in the mind of the Tax Court majority, namely, how far Congress can effectively go in enacting legislation by means other than bills passed by both Houses and placed before the President for his signature or veto?

The author of the Tax Court majority opinion, Honorable Leo Irwin, was a chief counsel of the House Ways and Means Committee for 14 years (see Congressional Directory, 1981 ed. at 741), and is entitled to special deference when he touches in an opinion, as he does here, upon transactions in the Congress.

I am sure the court will agree there would have been no regulation but for the so-called legislative history. The regulation was issued only in 1978, as Judge Irwin points out, and so is not contemporary with the legislation to be construed: actually it was finalized after the trial and briefing in this case. This reduces the deference to which the regulation would otherwise be entitled. The legislative history is the key to the case. The IRS Commissioner hardly can ignore the kind of pronouncement made in the Report of the Senate Finance Committee on the Tax Reform Act of 1969, S. Rep. No. 91-522 (1969) 1969-3 C.B. 500, 502, as quoted by the court, *supra*. But for that statement I do not think it would ever have occurred to anyone that legislation dealing with income and deductions of other taxpayers, § 83, implicitly denies a deduction

to a taxpayer that statute never mentions, to which he would otherwise be entitled. The suggestion is made that the convoluted language of § 83(h) indirectly indicates such an intention. The Tax Court is in a better position than we are to appreciate whether the Congress normally grants or withdraws deductions in such an arcane and cryptic manner.

The Committee Report is in my view ambiguous whether the legislative command there unambiguously stated derives its authority from—

- (1) The requirements of prior law, as construed by the Committee,
- (2) The requirements of the reported bill, as construed by the Committee, or
- (3) The command of the Senate Finance Committee itself.

My experience on the Hill is much inferior to Judge Irwin's. However, such as it is, it leads me to adopt explanation (3) as the correct one. The objections to (1) and (2) are compelling. If the Committee had intended (1), surely it would have explained how existing law so required. But in any case, the Committee's interpretation of prior law, though worthy of respectful consideration, is nowhere near as compelling on courts as its interpretation of the bill reported. If the Committee is in error about prior laws, courts are free to say so.

On the other hand, explanation (2) founders on the utter absence of congruity between the language of the bill and the language of the report. The latter deals with a subject the former never touches. It would seem any report draftsman, aware of the Committee's wishes, would not state them in the report without a glance at the bill. Making such a glance, he would perceive the absence of anything in the bill to match his statements about it, and he would leap to correct the deficiency in the bill. Or

would he? The legislative situation could make it difficult to amend the bill without endangering other purposes deemed more important, perhaps its passage in that session. There might be a temptation to try to put across a Committee command.

At any event, in support of the probability of (3) that the statement in question is a Committee command, everyone who has dealt with congressional committees knows that their reports, when made, are replete with Committee commands. They expect this, they require that, they disapprove of the other, and it must not be done. I suppose members and staff are all aware, when they think about it, that such Committee commands are of dubious legal authority. As a practical matter they are usually effective because addressed to persons who cannot afford to incur Committee wrath. The "legislative history" here involved is of course really addressed to the IRS Commissioner, who is commanded to try to put it across, and if he fails, that will occur many years hence, and besides, the wench will be dead. It will also be, though, the same country. (*Cf.* Christopher Marlowe.)

This may seem like an improbable scenario, and doubtless it is, but Conan Doyle's writings about Sherlock Holmes teach that, when all explanations of an occurrence are improbable, the more improbable ones must be rejected, and the least improbable accepted as true.

Judge Irwin expresses his appreciation of the situation in a more diplomatic manner, but as I read him, he perceives it as I do. He cannot see how the "legislative history" has any credibility or plausibility, other than as a Committee command. It follows that one must and I do conclude that the Finance Committee wanted very much for the stockholder to be required for tax purposes to treat as a capital contribution to the corporation the stock he distributed to employees to retain them in corporate employ. The only trouble is the Committee failed to embody its wishes in an enacted bill. If this

failure is not decisive of the case before us, the Committee is potent indeed.

I have not attempted to collect all the decisions dealing with this problem of statutory construction, which has become acute so recently, and of which even the capable counsel in the case before us may not be wholly aware. They did not cite one case which I deem to be a striking parallel. It is an *en banc* decision of the old Court of Claims, now defunct. *Hart v. United States*, 218 Ct. Cl. 212, 585 F.2d 1025 (1978), dealing with an earlier Revenue Act, that raised issues so complex I will not attempt to explain them. There were committee reports embodying a legislative command not stated in the bill reported, clearly or ambiguously. There was an obedient IRS Regulation. Reference is made to the discussion in that case and to the cases there cited. I will quote a few sentences, 218 Ct. Cl. at 231, 585 F.2d at 1035:

We could hope for beneficial results, too, if this case should lead congressional committees to write corrective legislation when they perceive errors in statutes, rather than make bold [bald?] assertions in committee reports, in the hope they will be accepted as valid legislative history. People are entitled to find in the statute books the laws that govern them. \* \* \*

UNITED STATES COURT OF APPEALS  
FOR THE SIXTH CIRCUIT

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No. 81-1447

HENRY C. TILFORD, JR., and BARBARA N. TILFORD,  
*Plaintiffs-Appellees,*

vs.

COMMISSIONER OF INTERNAL REVENUE,  
*Defendant-Appellant.*

[Filed May 27, 1983]

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ORDER

Before: EDWARDS, Chief Judge, JONES and NICHOLS,\*  
Circuit Judges.

On receipt and consideration of a petition for rehearing and suggestion for rehearing en banc in the above-styled case; and

No judge in active service in this court having moved for rehearing en banc and the motion therefore having been referred to the panel which heard the case; and

The panel having noted nothing of substance in said motion for rehearing which had not been carefully considered before issuance of the court's opinion,

Now, therefore, the motion for rehearing is hereby denied.

Entered by order of the Court

/s/ John P. Hehman,  
Clerk

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\* Honorable Philips Nichols, Jr., Circuit Judge for the United States Court of Appeals for the Federal Circuit, sitting by designation.

UNITED STATES COURT OF APPEALS  
FOR THE SIXTH CIRCUIT

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No. 81-1447

HENRY C. TILFORD, JR., and BARBARA N. TILFORD,  
*Petitioners-Appellees,*

vs.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent-Appellant.*

[Filed Apr. 20, 1983]

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Before: EDWARDS, Chief Circuit Judge, JONES, Circuit  
Judge and NICHOLS, Circuit Judge.

JUDGMENT

ON APPEAL from a decision of the Tax Court of the  
United States.

THIS CAUSE came on to be heard on the transcript  
of record from the said Tax Court and was argued by  
counsel.

ON CONSIDERATION WHEREOF, It is now here  
ordered and adjudged by the court that the decision of  
the said Tax Court in this cause be and the same is  
hereby reversed.

Each party to bear its own costs on this appeal.

ENTERED BY ORDER OF  
THE COURT

/s/ John P. Hehman  
JOHN P. HEHMAN  
Clerk



13a

Issued as Mandate: June 6, 1983

COSTS: None.

A True Copy.

Attest:

/s/ Linda L. Brinson  
Deputy Clerk

## APPENDIX B

## 75 UNITED STATES TAX COURT REPORTS

Docket No. 1334-77

HENRY C. TILFORD, JR., and BARBARA N. TILFORD,  
*Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent*

Filed October 20, 1980

Petitioner sold stock, subject to restrictions, in a corporation of which he was a majority shareholder, to employees in order to induce them to work for the corporation. *Held*: Capital loss deduction claimed by petitioner sustained, *Downer v. Commissioner*, 48 T.C. 86 (1967), followed. Sec. 1.83-6(d), Income Tax Regs., treating such transaction as capital contribution to the corporation, held invalid. *Held, further*, respondent's determination of ordinary income from sale of farm recapture property under sec. 1251, as a result of adjustments to the excess deductions account, sustained.

*H. Wayne Grant, Howell G. Clements, John T. Henniss, and James L. Bomar*, for the petitioners.

*John B. Harper*, for the respondent.

IRWIN, *Judge*: Respondent determined deficiencies in petitioners' income tax as follows:

<i>Year</i>	<i>Deficiency</i>
1966	\$ 4,467.67
1967	1,235.71
1969	58,372.10
1970	3,644.06
1972	68,650.84
1973	46,897.37

Due to concessions by petitioners, the only issues remaining for our consideration are:

(1) Whether section 83<sup>1</sup> denies petitioner a loss on the sale of stock of a corporation, in which he was the majority shareholder, made to employees of the corporation in order to induce them to work for it.

(2) Whether respondent correctly determined the excess deductions account for purposes of section 1251.

### FINDINGS OF FACT

Some of the facts have been stipulated. The stipulation of facts together with the exhibits attached thereto are incorporated herein by this reference.

Petitioners Henry C. and Barbara N. Tilford filed joint income tax returns for the years 1966, 1967, 1969, and 1970 with the Southeast Service Center, Chamblee, Ga. They filed their joint income tax returns for 1972 and 1973 (as amended) with the Memphis Service Center, Memphis, Tenn. At the time they filed their petition herein, petitioners resided in Shelbyville, Tenn. Barbara N. Tilford is a petitioner herein only because joint returns were filed for the years in issue. Therefore, references to "petitioner" will be to Henry C. Tilford, Jr.

#### *Issue 1. Capital Loss Deductions*

Watco, Inc., is a Tennessee corporation, chartered in November 1968. Its principal offices are located in Shelbyville, Tenn. Watco is primarily engaged in the manufacture and sale of commercial signs.

Petitioner has been a principal officer and either the sole or majority shareholder of Watco since its incorporation. In most years, petitioner was Watco's presi-

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<sup>1</sup> Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954 as in effect during the years at issue.

dent, and during the years in issue was chairman of the board of directors. By December 31, 1970, petitioner had invested \$350,000 in Watco stock, owning 100 percent of its 170,000 issued shares, and had loaned it an additional \$79,500.

Watco was started by petitioner and a friend, Eddie Watson. Petitioner was to put up the money, and Watson was to manage the company. When the company began operations, it manufactured a "vacuum form magnetic" sign which is affixed to the sides of trucks and cars to identify a business. It rented a small building and hired two employees. During 1969, the company grew to three or four employees but was losing money because of inadequate sales. By 1970, Watson had talked to petitioner into enlarging the business to manufacture electric trailer signs in hopes of generating greater sales and earning a profit. This expansion necessitated the hiring of more employees and a move to a larger building.

Neither Watson nor petitioner had any knowledge or experience in manufacturing signs, and petitioner had to hire experienced personnel to manage both the manufacturing and marketing aspects of the company, as well as for administrative functions. As an inducement in hiring these key personnel—Pat Driscoll, Dorothy Haithcote, and Ronnie Besaw—they were told that they would eventually participate as owners in the business.

On March 29, 1971, petitioner sold portions of his Watco stock for \$1 per share to Driscoll (4,500 shares), to Besaw (3,500 shares), to Haithcote (500 shares), to Mays Montgomery, a commercial salesman (750 shares), and to Ben Kingree, petitioner's attorney, who was also a director of Watco (750 shares). Each purchaser paid a total of \$1 per share for all of the shares acquired. The amount of shares sold to each individual was based upon what petitioner considered to be his relative importance to the company. An additional 100 shares were sold in

1971 to Bayard Tarpley, a retired attorney who had previously done some work for both petitioner and Watco.

Petitioner considered it to be advantageous for these employees to be shareholders, and he sold the stock for \$1 because he believed it had no market value. Petitioner reserved a right of first refusal to repurchase the stock at book value within 5 years in the event that a purchasing employee desired to sell his stock or in the event his employment with Watco was terminated (voluntarily or otherwise). The stock sold was deposited in escrow with the Peoples National Bank of Shelbyville in order to assure petitioner his rights under the contract.<sup>2</sup> Additional stock was sold to Driscoll and Haithcote on December 22, 1972, on similar terms, although the contract with Haithcote had the additional provision that after 5 years, in the event Haithcote desired to sell the stock to a third party, petitioner had a right of first refusal to buy the stock at the price Haithcote was offered by the third party.

Watco continued to lose money after these employees were hired, and it had to borrow funds for current

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<sup>2</sup> These contracts typically stated, in pertinent part, as follows:

"H. C. TILFORD, JR., has this day sold to —, —, —, — shares of the common capital stock of Watco, Inc. for the consideration of \$1.00 and for further consideration of affording — an opportunity to acquire a financial interest in Watco, Inc., by which he is being employed.

"This stock is sold with the express understanding and agreement that in the event the purchaser should at any time within five (5) years from date either (1) desire to sell said stock, or (2) terminate his employment with Watco, Inc. either voluntarily or otherwise, the said H. C. Tilford, Jr., shall be accorded the first right of refusal to purchase said stock at a price equivalent to its then existing book value as determined by Watco, Inc. accounting firm. Upon the transfer of this stock to purchaser, the purchaser shall thereupon endorse the stock certificate in blank and deposit same in escrow for a period of five (5) years with the Peoples National Bank of Shelbyville, Tennessee, to assure the performance on the part of the purchaser of the covenant relating to the first right of refusal to purchase same."

operations. Petitioner was required to guarantee these borrowings, as well as Watco's accounts payable, because of its poor financial condition, and by the end of 1971, the total amount guaranteed was over \$300,000. Eventually, petitioner guaranteed over \$900,000 of Watco's loans and accounts payable.

Due to large losses, petitioner considered selling, merging, or liquidating the business in late 1971, and hired a consultant, Barry Winston, for advice. After reviewing Watco's balance sheet, personnel, and facilities, Winston told petitioner he had to find a knowledgeable person to manage the company; otherwise, if he could not sell it, he should liquidate. Petitioner did not desire to liquidate the company, and Winston was then asked to find a qualified manager.

Winston also explored possibilities of merging with Winkler Sig Corp. but that transaction, as well as a possible sale to United Advertising Co., never materialized. There was one other company which looked seriously at the prospect of purchasing Watco, but it eventually rejected the idea because it determined that Watco was not a good investment.

After several months, in September 1971, Watco hired Nelson Early under a 2-year employment contract to help manage the company. At the time, petitioner told Early he thought Early should also become a shareholder in Watco, and in November 1971, petitioner sold Early 5,000 shares for \$1 on the same terms as the previous sales. Petitioner also told Early that he would provide the additional capital that Watco needed in order to continue operations and expand.

After he hired Early, petitioner received an application for the job from Tom Watson. Watson came highly recommended and, after negotiations, was hired in late 1971. As part of his employment terms, Watson demanded stock in the company and in November 1971

purchased 22,000 shares from petitioner for \$1 on the same terms as the previous sales. Petitioner assured Watson, moreover, that he would continue to put up money for the corporation. Watson then hired Leo Pitt; 4,000 shares were also sold to him at \$1 in order to induce him to come to work for Watco. Pitt's contract concerning the Watco shares was similar to the previous contracts except that one of petitioner's rights was described as a "right at his sole option to repurchase stock" rather than a "right of first refusal." It also contained a provision that if the stock was transferred without petitioner's being accorded the right to repurchase the stock, Watco had the right to refuse to transfer any stock certificate on its stock ledger. When Pitt left Watco in late 1972 or early 1973, petitioner repurchased the stock for \$1. Pitt believed it had no value at that time.

Sales increased in 1972, and Watco expanded to about 40 employees. In order to obtain the sales, however, Watco was required to sell its signs below cost, and substantial losses were incurred. Watson then brought in an expert in manufacturing to reduce costs. Early then became disenchanted because of Watson's control and left Watco, pursuant to a mutually agreed upon rescission of his contract. Early sold his shares back to petitioner for \$1.

Watson also left later, due to personal problems, and sold back his shares to petitioner for \$1. Petitioner, in turn, in October 1972, sold 18,000 of these shares to Robert Price (one of the original employees of the company) for \$1. Petitioner later sold an additional 9,000 shares to Price for \$1.

Watco hired Tom Cannon in 1973 to manage its national sales. Petitioner sold Cannon 24,500 shares of Watco for \$1. In addition to the terms set forth in the original agreements, the stock was to be escrowed for 6 years instead of 5, and petitioner had the right to

repurchase the stock at \$1 if Cannon left Watco within 1 year. After 5 years, petitioner had the right of first refusal to repurchase at any price Cannon could otherwise obtain.<sup>3</sup> Cannon then hired two salesmen, Jim

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<sup>3</sup> The contract read, in pertinent part:

"This stock is sold subject to the following terms and conditions:

"A. That the parties hereto agree that in the event the Purchaser shall at any time within one (1) year from the date of the execution of this agreement either (1) desire to sell the subject stock or (2) terminate his employment with WATCO, INC., either voluntarily or otherwise, the said H. C. TILFORD, JR. shall be accorded the right to repurchase said stock for the price of One (\$1.00) Dollar.

"B. That the parties hereto agree that in the event the Purchaser should at any time within the next five (5) years thereafter from the date of termination of the one (1) year period set forth in (A) above, either (1) desire to sell the subject stock or (2) terminate his employment with WATCO, INC., either voluntarily or otherwise, the said H. C. TILFORD, JR. shall be accorded the right at his sole option to repurchase the subject stock at a price equivalent to the then existing book value of the subject stock, as determined by accountants of or selected by WATCO, INC.

"C. That upon the transfer of the stock to the Purchaser the Purchaser shall endorse the stock certificate in blank and deposit the same in escrow for a period of six (6) years with the Peoples National Bank of Shelbyville, Tennessee, as Escrow Agent. The parties hereto agree that this provision assures the performance on the part of the Purchaser of the covenants stated in paragraphs "A" and "B" above relating to Tilford's sole option to repurchase the subject stock.

"D. That after six (6) years from the date of this contract, the Purchaser shall be permitted to sell said stock to third parties. However, he shall first offer said stock to the Seller at a price equivalent to that which he proposes to receive from said third parties, and the Seller shall have ten (10) days to purchase said stock at said price. If the Seller does not exercise this option to purchase, then, the Purchaser shall be free to sell said stock to third parties at said price, but he shall not sell said stock to third parties at a lesser price than originally offered unless he first gives to the Seller a ten (10) day option to buy same at said lesser price.

"E. That in the event the subject stock should be transferred to a third party without Tilford's being accorded the option to pur-



McMullen and Jim Marren, who were also offered, and purchased from petitioner, 24,500 and 14,700 shares in Watco, respectively, for \$1 and on the same terms Cannon purchased his stock. Petitioner assured these two salesmen that he would continue to commit his personal resources to keep Watco going. Without this commitment, they would not have agreed to come to work for Watco. After these three individuals were hired, sales increased, but expenses also increased, and Watco continued to lose money.

Price eventually decided to retire and, pursuant to petitioner's right of first refusal, sold back his 27,000 shares to Watco to petitioner for their book value, a total of \$9,318.55. McMullen, Cannon, and Marren also eventually decided to leave Watco, and each sold his stock back to petitioner for \$1.

Petitioner claimed losses from the sales of Watco stock to Tarpley, Kingree, and the key employees, except for the stock sold to Price (since he had repurchased these shares from Watson for \$1 and, therefore, had a basis of only \$1). Respondent disallowed the deductions for the losses and determined the sales to be transfers of property in connection with the performance of services that must be treated as contributions to capital of Watco under section 83.

### *Issue 2. Income From Farm Recapture Property*

Bedford Farms, Inc., is a Tennessee corporation chartered on April 26, 1960. It owns and operates a farm of approximately 1,000 acres near Shelbyville, Tenn. On January 5, 1966, Bedford Farms elected tax options status under section 1372. The corporation's business activities during the years in question included selling

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chase stated in paragraphs "A", "B", "C", and "D" above, WATCO, INC. shall have the right to refuse to transfer any stock certificates, so transferred on the stock ledger of the corporation."

farm products, renting farm property and equipment, and raising and selling cattle and other livestock.

During the years in question, Bedford Farms had outstanding 750 shares of common stock, owned as follows:

<i>Shareholder</i>	<i>Shares</i>
Henry C. Tilford, Jr.	739
Barbara N. Tilford	10
Henry C. Tilford III	1

On its 1973 income tax return, Bedford Farms reported taxable income of \$119,150.27. It reported a sale of breeding stock at a gain of \$269,905.02. Of this amount, \$40,829.03 was reported as ordinary gain, and \$229,075.99<sup>4</sup> was reported as capital gain, both of which were used to arrive at taxable income. On Schedule K (Computation of Undistributed Taxable Income and Summary of Distributions) of Bedford Farms' Form 1120S, the corporation's undistributed taxable income is listed as \$119,150.27. All of this amount is listed as undistributed taxable income taxable as long-term capital gain.

In the notice of deficiency to petitioner, respondent determined that \$51,436.70 of a long-term capital gain reported as petitioner's distributive share of the capital gains of Bedford Farms, Inc., should have been reported as ordinary income under the farm loss recapture of section 1251. Accordingly, petitioner's capital gains were reduced, and his share of the undistributed taxable income of Bedford Farms was increased. The parties agree that the figures used by respondent in making this determination are correct but do not agree that respondent's method of computation and, therefore, the results of the computation, are correct. The following is respondent's computation of the 1973 increase in Bedford Farms' ordinary income for 1973, as set forth in the notice of deficiency:

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<sup>4</sup> The return shows \$229,175.99, which is \$100 in error.

COMPUTATION OF ORDINARY INCOME UNDER THE  
RECAPTURE OF SECTION 1251, IRC OF  
BEDFORD FARMS, INC.

Since the nonfarm adjusted gross income of the major shareholder, Henry C. Tilford, Jr., plus the nonfarm adjusted gross income of Bedford Farms, Inc. (none exceeded \$50,000.00) in each of the taxable years 1972 and 1973, and Bedford Farms net loss for each of those years exceeded \$25,000.00, the recapture of farm loss provisions of section 1251 applies and gain from farm recapture property of \$161,439.05 is reclassified as ordinary income for the taxable year 1973, as detailed below.

	1972	1973
Farm net loss:		
Total income shown in return, Form 1120S	\$128,434.33	\$372,157.96
Less gain in disposition of farm recapture property referred to in sec. 1231(a)—excluded from computation under sec. 1251(e) (2)	20,169.14	229,075.99
Gross farm income as adjusted	108,265.19	143,081.97
Less deductions:		
Total deductions shown in schedule	\$212,693.60	\$253,007.69
Less insurance expense disallowed; This report	1,450.36	1,462.72
Farm deductions as determined	(211,243.24)	(251,542.97)
Farm net loss as determined	(102,978.05)	(108,461.00)
Less exclusion provided by sec. 1251(b) (2) (B) (ii)	25,000.00	25,000.00
Addition to excess deduction account for each year	(77,978.05)	(83,461.00)
Balance in excess deduction account at the end of 1973 to be recaptured as ordinary income from the sale of farm recapture property during that year:		
Balance in EDA account at 1/1/73 as determined above		\$77,978.05
Addition to the account for 1973, as shown above		83,461.00
Balance in EDA account at 12/31/73 and gain recognized as ordinary income under sec. 1251(c) (1)		161,439.05

Respondent decreased Bedford Farm's net long-term capital gain from \$229,075.99 by this \$161,439.05 to \$67,636.94 and increased ordinary income of \$40,829.03 by the same \$161,439.05. The effect was to change \$52,978.05 of the \$120,614.99 taxable income of Bedford Farms from long-term capital gain to undistributed taxable income.<sup>5</sup> Petitioner's share of the undistributed taxable income was determined to be \$52,907.41.

Respondent then reduced the \$119,150.27 reported on petitioner's 1973 return as net long-term capital gain from Bedford Farms by \$51,436.70. This was done by first subtracting the portion of Bedford Farms' capital gain respondent attributed to petitioner's son, \$166.81, and then by subtracting petitioner's share of the net long-term capital gain derived from the sale after application of section 1251.

## OPINION

### *Issue 1. Capital Loss Deductions*

Petitioner transferred stock in his corporation, subject to certain restrictions, to certain key employees to induce them to remain with, or to come to work for, the corporation. Many of these employees were promised, at the time of receipt of the stock, that petitioner would continue to apply his personal resources to Watco in order to keep it operating in the face of large operating deficits. The number of shares transferred to each employee was based upon the importance of the employee to the company, and petitioner considered it important for the key employees to have a proprietary interest in Watco. Petitioner claimed loss deductions on his income tax return with respect to these transfers of shares.<sup>6</sup>

<sup>5</sup> \$119,150.27, as reported, plus \$1,464.72, representing a deduction claimed for insurance premiums disallowed by respondent, not in dispute here.

<sup>6</sup> Petitioner's primary contention is that the transfer amounted to sales of the stock, giving rise to deductions under sec. 1002. Alternatively, petitioner claims ordinary loss deductions on the

The instant case is similar in its facts to *Downer v. Commissioner*, 48 T.C. 86 (1967). There, the taxpayer, the majority shareholder of a corporation, transferred 100,000 shares of stock in the corporation to an employee of the corporation to induce the employee to continue work. The taxpayer's basis in the 100,000 shares was \$100,000, and the shares had a fair market value of \$15,000. We held that the taxpayer did not make a capital contribution to his corporation of the 100,000 shares, as the Commissioner contended, but rather, the transaction constituted a "sale or exchange," and the taxpayer suffered an \$85,000 capital loss. In the instant case, the facts are similar except that petitioner transferred the stock subject to certain restrictions imposed on the transferees, while in *Downer*, there apparently were no such restrictions. Respondent, however, does not attempt to distinguish *Downer* on that basis, but rather, maintains that regardless of the *Downer* facts and the *Downer* result, the transactions in the instant case fall under the rules of section 83, which was not in effect at the time of the *Downer* case.

Section 83 was added to the Internal Revenue Code by the Tax Reform Act of 1969, Pub. L. 91-172, 83 Stat. 588, and it applies (with certain transitional exceptions) to transfers after June 30, 1969. This section deals with the tax consequences of transfers of property in connection with the performance of services, and it was enacted primarily to deal with certain so-called "restricted stock" compensation plans. In general, section 83 provides that property received for the performance of services is to be included in the income of the recipient (at its fair market value); however, if the property is not freely transferable by the recipient, or is subject to for-

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theory that, in substance, the stock was surrendered to the corporation for use as employee compensation, and such a transaction is not a sale or exchange. See *Smith v. Commissioner*, 66 T.C. 622 (1976), revd. sub nom. *Schleppy v. Commissioner*, 601 F.2d 196 (5th Cir. 1979); *Estate of Foster v. Commissioner*, 9 T.C. 930 (1947).

feiture, the value of the property is determined and taken into income only upon the termination of such restrictions. In addition to prescribing rules for the taxability of the recipient, section 83 provides a corresponding deduction "under section 162" to the party for whom the services were performed, keyed to match the timing of the reporting of the income by the recipient. Sec. 83(h).

The Treasury regulations under section 83 were finalized subsequent to the trial and briefing in this case (T.D. 7554, filed July 21, 1978), although they were published in proposed form prior thereto. The heart of the issue in this case involves section 1.83-6(d), Income Tax Regs., upon which respondent relies in disallowing the losses claimed. This regulation provides as follows:

(d) *Special rules for transfers by shareholders—*

(1) *Transfers.* If a shareholder of a corporation transfers property to an employee of such corporation or to an independent contractor (or to a beneficiary thereof), in consideration of services performed for the corporation, the transaction shall be considered to be a contribution of such property to the capital of such corporation by the shareholder, and immediately thereafter a transfer of such property by the corporation to the employee or independent contractor under paragraphs (a) and (b) of this section. For purposes of this (1), such a transfer will be considered to be in consideration for services performed for the corporation if either the property transferred is substantially nonvested at the time of transfer or an amount is includible in the gross income of the employee or independent contractor at the time of transfer under § 1.83-1(a)(1) or § 1.83-2(a). In the case of such a transfer, any money or other property paid to the shareholder for such stock shall be considered to be paid to the corporation and transferred immediately thereafter by the corporation to the shareholder as a distribution to which section 302 applies.

This regulation is based upon the following language in the report of the Senate Finance Committee on the Tax Reform Act of 1969:

In general, where a parent company's or a shareholder's stock is used to compensate employees under a restricted stock plan, the transfer of the stock by the parent company or shareholder is to be treated as a capital contribution to the company which is to be entitled to a deduction in accordance with the restricted property rules. The parent company or the shareholder merely is to reflect the contribution as an increase of the equity in the company which is entitled to the compensation deduction. [Tax Reform Act of 1969, S. Rept. 91-522 (1969), 1969-3 C.B. 500, 502]

Of course, it is well established that Treasury regulations, when not inconsistent with express statutory provisions, have the force of law. *Maryland Casualty Co. v. United States*, 251 U.S. 342 (1920). See sec. 7805. As such, they should not be overruled except for weighty reasons. *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496 (1948), revg. 162 F.2d 866 (5th Cir. 1947), revg. 7 T.C. 669 (1946). Ordinarily, regulations must be sustained unless they are unreasonable and plainly inconsistent with the revenue statute. *Topps of Canada, Ltd. v. Commissioner*, 36 T.C. 326 (1961). Petitioner herein contends that the regulation in question is unreasonable and is not supported by the statute.

Section 83 is basically an income-defining section, enacted primarily to deal with the recognition of income under certain restricted stock compensation plans. The matter at issue here is a claimed deduction. But for subsection (h), section 83 really has nothing to do with deductions. Section 83(h) provides a deduction "under section 162" for the employer, to correspond in time with the income required to be reported by the employee. This subsection does not address itself to the tax consequences



to a stockholder who provides the shares used in the restricted stock plan. Thus, it would appear that section 1.83-6(d), Income Tax Regs., is clearly outside the scope of the statutory provisions of section 83.

Petitioner's claim for a loss deduction in this case is based upon section 1002, which provides for recognition of gain or loss upon the sale or exchange of property.<sup>7</sup> The facts are quite clear in this regard: petitioner sold shares of Watco stock to various employees for nominal consideration.<sup>8</sup> The fact that these sales were in connection with the rendering of services by the purchasers, while it may bring into play certain tax consequences to the employees and Watco under section 83, does not render the transaction any less a sale under section 1002, as far as petitioner is concerned. Thus, we believe that section 1.83-6(d), Income Tax Regs., is contrary to the express terms of the Code (i.e., sec. 1002) insofar as it would preclude the recognition of a loss on a sale of securities by characterizing the sale as a contribution to capital.

Moreover, the regulation in question flies in the face of numerous decisions of this and other courts holding that non-pro-rata surrenders of stock to the issuing corporation do not represent capital contributions but give rise to deductible losses. See, e.g., *Downer v. Commissioner*, *supra*; *Sack v. Commissioner*, 33 T.C. 805 (1960); *Estate of Foster v. Commissioner*, 9 T.C. 930 (1947); *Miller v. Commissioner*, 45 B.T.A. 292 (1941), acquiesced 1941-2 C.B. 9, acquiescence withdrawn and nonacquiescence substituted 1977-1 C.B. 2; *Budd International Corp. v. Commissioner*, 45 B.T.A. 737 (1941), acquiesced 1942-2 C.B. 3, acquiescence withdrawn and nonacquies-

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<sup>7</sup> Since 1976, the provisions of sec. 1002 have been embodied in sec. 1001(c).

<sup>8</sup> Despite the restrictions on resale and the contingent right of petitioner to repurchase the stock sold, all of the sales in question appear to be closed transactions for tax purposes.



cence substituted 1977-1 C.B. 2, revd. on other grounds 143 F.2d 784 (3rd Cir. 1944), cert. denied 323 U.S. 802 (1945); *Peabody Coal Co. v. United States*, 80 Ct. Cl. 202, 8 F. Supp. 845 (1934); *Burdick Executrix v. Commissioner*, 20 B.T.A. 742 (1930), nonacquiesced X-2 C.B. 82 (1931), affd. on other grounds 59 F.2d 395 (3rd Cir. 1932); *Wright v. Commissioner*, 18 B.T.A. 471 (1929). But see *Schleppy v. Commissioner*, 601 F.2d 196 (5th Cir. 1979), revg. *Smith v. Commissioner*, 66 T.C. 622 (1976), in which a surrender of stock not involving a transfer to a third party, was treated as a capital contribution.

In support of section 1.83-6(d), Income Tax Regs., respondent relies heavily upon the language of the Senate committee report quoted above. There can be no doubt that the regulation specifically follows the dictates of the committee report. However, the committee report is not the statute, and to the extent that its language goes beyond the legislation then being enacted or theretofore existing statutory provisions (i.e., sec. 1002), it certainly cannot serve as support for a regulation suffering the same infirmity. *Flex-O-Glass, Inc. v. United States*, an unreported case (N.D. Ill. 1959, 3 AFTR 2d 1034, 59-1 USTC par. 9328). This is particularly so in light of the long history of litigation, cited above, in which the Government had consistently failed to establish that non-pro-rata stock surrenders amounted to capital contributions, rather than recognizable losses. Certainly, if the Congress had intended to change the result of these cases, it could and should have done so by specific codification. Legislative history is strictly a tool of statutory interpretation (cf. *Gilbert v. Commissioner*, 241 F.2d 491 (9th Cir. 1957), revg. 25 T.C. 81 (1955)); it cannot be infused with an authority of its own.

Another argument which might be advanced in support of the regulation in question is that because section 83(h) allows a deduction which might not have been allowable under the prior case law (i.e., the deduction to

the corporation, even though the compensation for services is effectively being paid by the stockholder), it is necessary to eliminate the stockholder's loss deduction previously allowed in the cases; otherwise section 83(h) would have, in effect, created a double deduction.<sup>9</sup> Although this argument at first blush has a persuasive ring, it does not withstand careful scrutiny. We do not view the loss resulting from the disposition of shares by a stockholder as the same economic loss or expenditure as that associated with the payment for services rendered. In other words, the deduction provided by section 83(h) merely recognizes that whenever income is required to be reported under section 83, there should be a matching *business expense* deduction under section 162; this has no inherent relationship with the realization of a gain or loss by a stockholder upon disposition of shares in return for services. Regardless of the fact that the disposition of shares is in a transaction which brings section 83 into play with respect to other parties, the relevant question for the stockholder is simply whether or not there has been a realization of a gain or loss in a transaction which warrants recognition of gain or loss for tax purposes.

Another reason that we are not persuaded by the "double deduction" argument is that it seems clear that such a "double deduction" *would* be appropriate in a case where stock is used in payment for services rendered directly to and for the benefit of the business of the stockholder, and not for the corporation. Thus, if services are paid for by the recipient thereof with securities

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<sup>9</sup> This argument can be stated another way as follows: If a stockholder pays the expense of his corporation, the corporation might claim the deduction on the theory that, in substance, the stockholder made a capital contribution and the corporation paid the expense. After the enactment of sec. 83(h) codifying the corporation's deduction, consistency of the theoretical construction requires that the paying stockholder be deemed to have made a capital contribution.

which have increased or decreased in value, the transaction would result in a capital gain or loss to such recipient (relating to the economic gain or loss during the holding period of the securities), as well as a business expense deduction for the cost (measured by the value of the services rendered. *United States v. General Shoe Corp.*, 282 F.2d 9 (6th Cir. 1960); *International Freightling Corp. v. Commissioner*, 135 F.2d 310 (2d Cir. 1943), affg. 45 B.T.A. 716 (1941). In the factual situation where the services are performed for the corporation, and not for the stockholder himself, as in *Downer* and its predecessors, prior to the enactment of section 83(h), the business expense deduction might have been lost because the expense was paid by another party. See *Zoby v. United States*, 364 F.2d 216 (4th Cir. 1966). Economically, the business expense was still incurred. Therefore, as we view it, the enactment of section 83(h), rather than allowing a double deduction, merely has the effect of allowing the business expense deduction which may have been previously disallowed solely for technical reasons. Again, the realization of a capital gain or loss to the stockholder should be viewed as a separate transaction.<sup>10</sup>

Moreover, if one is to accept the double deduction argument, and to treat the stockholder as having made a capital contribution to the corporation, the result would be merely a *deferral* of the gain or loss with respect to the shares transferred, with their basis added to the basis of the shares retained. However, such a "unitary view" of a stockholder's investment in his corporation was analyzed and specifically rejected in *Downer* (48 T.C. at 91). Under the *Downer* "fragmented view" of stock owner-

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<sup>10</sup> To the extent that the allowance of a deduction by sec. 83(h) requires that the amount deducted be deemed to have been first contributed to capital by the stockholder who actually paid the deductible amount, such stockholder's capital gain or loss would still be recognized on the theory that, in substance, his stock was sold for cash, which cash was in turn contributed to the corporation.

ship, the disposition of a portion of one's stockholdings would ordinarily call for a recognition of gain or loss with respect to that portion, rather than an adjustment to the basis of the remaining shares.<sup>11</sup> Again, the fact that section 83(h) now allows a business expense deduction to the corporation does not seem to produce any inherent inequity or loophole which would require the deferral of a gain or loss that would otherwise be recognized under the application of normal tax principles.

Finally, it should be noted that throughout the foregoing discussion, we have referred to "gain or loss" recognition upon the transfer of shares for services. Although the instant case and its predecessors involve the question of a loss deduction with respect to shares that have decreased in value, section 1.83-6(d), Income Tax Regs., if upheld, would apply equally to transfers of appreciated stock. This would result in a deferral of capital gain upon the transfer of appreciated stock for services rendered to the corporation, which deferral in our view would have no justification; in a capital gain situation the "double deduction" argument is, of course, obliterated.

In light of all of the foregoing, we hold that petitioner is entitled to capital loss deductions with respect to the sales of stock in question. *Downer v. Commissioner*, *supra*.

### *Issue 2. Income From Farm Recapture Property*

Section 1251, in general, provides that if farm recapture property is disposed of, the gain realized is treated

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<sup>11</sup> "There is no persuasive reason why the shareholder's recognition of loss with respect to the surrendered stock should be suspended simply because he holds additional stock of the same corporation." See G. Bolding, "Non-Pro Rata Stock Surrenders, Capital Contribution, Capital Loss or Ordinary Loss?" 32 Tax Law. 275, 278 (1979).

as ordinary income to the extent of the amount contained in the taxpayer's "excess deductions account" (EDA).

Subject to certain dollar limitations, in general, a taxpayer's EDA increases by the amount of his farm net loss each year (sec. 1251(b)(2)) and decreases by the amount of his farm net income (section 1251(b)(3)). Farm net loss is defined in section 1251(e)(2) as:

(2) FARM NET LOSS.—The term "farm net loss" means the amount by which—

(A) the deductions allowed or allowable by this chapter which are directly connected with the carrying on of the trade or business of farming, exceed

(B) the gross income derived from such trade or business.

Gains and losses on the disposition of farm recapture property referred to in section 1231(a) (determined without regard to this section or section 1245(a)) shall not be taken into account.

Total gross income shown on Bedford Farms' return was \$128,434.33 in 1972 and \$372,157.96 in 1973. From these amounts, respondent subtracted \$20,169.14 in 1972 and \$229,075.99 in 1973 in arriving at a revised gross income of \$108,265.19 in 1972 and \$143,081.97 in 1973. It is this reduction in gross income, leading to a corresponding increase in Bedford Farms' farm net loss and, in turn, a larger addition to the EDA in each of the years, that is in issue here.

In making his adjustment, respondent relies on the flush language in section 1251(e)(2) which provides that "Gains and losses on the disposition of farm recapture property referred to in section 1231(a) \* \* \* shall not be taken into account." Bedford Farms reported capital gains of \$20,169.14 in 1972 and \$229,075.99 in 1973 from the sale of breeding cattle, and it is these

gains which respondent has eliminated in computing "farm net loss" and the additions to the EDA. There is no dispute that this breeding cattle is livestock within the meaning of sections 1231(a) and 1231(b)(3) and, thus, farm recapture property. Under a literal reading of the statute, therefore, respondent is correct in his determination. Petitioner contends, however, that because the \$20,169.14 in 1972 and \$109,925.72 of the \$229,075.99 in 1973 were not passed through by Bedford Farms as capital gains to petitioner on his personal returns, due to certain statutory limitations applicable to subchapter S corporations,<sup>12</sup> such amounts do not constitute farm recapture property.

Petitioner maintains that because these amounts were not passed through as capital gains to the shareholders, they were effectively treated as ordinary income by Bedford Farms and thus did not constitute the proceeds from section 1231 property. Although petitioner's argument is ingenious, we must reject it. Section 1.1375-1(d), Income Tax Regs., provides, with exceptions not here relevant, that "for purposes of determining whether gain on the sale or exchange of an asset by an electing small business corporation is capital gain, the character of the asset is determined at the corporate level." Bedford Farms sold section 1231 property and, therefore, regardless of the character of the pass through of the gain to petitioner, it follows that such amounts are capital gains properly reported as such by Bedford Farms. Although petitioner may not have benefited from the capital gain treatment, this situation, in our view, does not warrant a result at variance with the literal language of section 1251(e)(2).

Petitioner next argues that respondent failed to properly reduce Bedford Farms' EDA by \$56,860.89 in 1972.

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<sup>12</sup> The limitation is not disputed by respondent. Sec. 1375 and sec. 1.1375-1(a), Income Tax Regs., provide that capital gains of a subch. S corporation can be passed through to its shareholders only to the extent of current earnings and profits.

On his 1972 return, petitioner reported adjusted gross income of negative \$7,674.92 (including a loss of \$84,141.50 attributable to his share of Bedford Farms' loss (\$84,259.27)) and itemized deductions of \$46,185.97. After deducting an additional \$3,000 for exemptions, petitioner showed taxable income of negative \$56,860.89. Relying upon section 1251(b)(3)(A), petitioner maintains that \$56,860.89 of the \$84,141.30 loss should reduce Bedford Farms' EDA.

Section 1251(b)(3) provides:

(3) SUBTRACTIONS FROM ACCOUNT.—If there is any amount in the excess deductions account at the close of any taxable year (determined before any amount is subtracted under this paragraph for such year) there shall be subtracted from the account—

(A) an amount equal to the farm net income for such year, plus the amount (determined as provided in regulations prescribed by the Secretary or his delegate) necessary to adjust the account for deductions which did not result in a reduction of the taxpayer's tax under this subtitle for the taxable year or any preceding taxable year, and

(B) after applying paragraph (2) or subparagraph (A) of this paragraph (as the case may be), an amount equal to the sum of the amounts treated, solely by reason of the application of subsection (c), as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

Petitioner argues that the amount of the negative taxable income in his 1972 return, \$56,860.89, constitutes "the amount \* \* \* necessary to adjust the [EDA] account for deductions which did not result in a reduction of the taxpayer's tax \* \* \* for the taxable year or any preceding taxable year," within the meaning of subparagraph (A) quoted above.



The reduction provided in subparagraph 1251(b)(3)(A) is specifically to be determined as provided in regulations prescribed by the Secretary of the Treasury. The governing regulations are found in section 1.1251-2(c)(3), Income Tax Regs. These regulations provide complex mechanics for the computation of both a "temporary subtraction" from the EDA (sec. 1.1251-1(c)(3)(ii), Income Tax Regs.) and a "permanent subtraction" from the EDA (sec. 1.1251-2(c)(3)(iii), Income Tax Regs.). The temporary subtraction is applicable for any given taxable year only in the determination of farm property recapture income for that year, if any; it does not affect the EDA which gets carried forward to succeeding taxable years. Thus, the "temporary subtraction" rules are not applicable with respect to petitioner's 1972 EDA balance (which is carried forward into 1973 for purposes of determining ordinary income from Bedford Farms' sale of farm recapture property in that year).

With regard to the permanent subtraction from the EDA for deductions not giving rise to tax benefits, subdivision (iii) of section 1.1251-2(c)(3), Income Tax Regs., limits this as follows:

(iii) *Permanent subtraction.* The amount permanently subtracted from the excess deductions account for a taxable year is the excess of the farm portion of any net operating loss which may be carried to the preceding year (reducing by the portion of such loss which reduced taxable income (computed without regard to the deduction under section 172(a)) for such preceding year) over the amount of such loss which may be carried to the taxable year, but the subtraction shall not be made earlier than the taxable year in which the excess deductions account is increased by reason of such loss.

Thus, the permanent adjustment to petitioner's EDA for 1972 would be applicable only with respect to certain



prior years' net operating losses. The foregoing regulation does not contemplate a reduction in the EDA with respect to negative taxable income (or even operating losses) of the current tax year, and thus, section 1251 (b) (3) (A) cannot be interpreted to permit the reduction urged by petitioner.<sup>13</sup>

However, from our review of petitioner's income tax returns included in the record, it appears that the permanent EDA reduction provided in section 1.1251-2(c) (3) (iii), Income Tax Regs., might be applicable in 1972 or 1973 with respect to net operating loss carryovers from prior years. Thus, a net operating loss carryover from a year prior to 1971 might result in the carryover to 1971 exceeding the carryover to 1972 or the carryover to 1972 exceeding the carryover to 1973. In either event, the amount of such excess would require a permanent adjustment in the taxpayer's EDA, which in turn would affect the amount of farm recapture income in 1973. The amount of such adjustment, if any, may be determined in the computation under Rule 155.

*Decision will be entered under Rule 155*

Reviewed by the Court.

SCOTT, J., dissenting: I respectfully dissent from the holding of the majority on the capital loss issue in this case. I agree that our cases cited by the majority for the proposition that "non-pro-rata surrenders of stock to the issuing corporation do not represent capital contributions, but give rise to deductible losses" so hold.

<sup>13</sup> Unlike the regulation held invalid in our opinion on the first issue in this case, sec. 1.1251-1(c) (3), Income Tax Regs., has not been challenged by petitioner, and it appears to be a reasonable and well thought out (although well nigh unreadable) attempt to apply the policy contemplated in the statute. Moreover, this regulation was promulgated under specific statutory mandate and, thus, must be accorded nearly statutory weight. See *Rudd Mfg. Co. v. Commissioner*, 10 T.C. 14 (1948), *affd.* 173 F.2d 222 (3d Cir. 1949).

However, I do not agree that any other court has so held. The Court of Appeals for the Fifth Circuit in *Schleppy v. Commissioner*, 601 F.2d 196 (5th Cir. 1979), in reversing *Smith v. Commissioner*, 66 T.C. 622 (1976), held to the contrary. After referring to the holdings of this Court allowing a loss for the non-pro-rata surrender of stock by a stockholder to the issuing corporation, the Circuit Court stated: "We find no Court of Appeals decision that determines the correctness of these decisions. We therefore write on a clean sheet."

In my view, we have been incorrect in our holding that an individual who transfers stock either to the corporation or to a third party for the benefit of the corporation sustains a loss. The Supreme Court and numerous lower courts, including this Court, have uniformly held that a payment by a stockholder for the benefit of his corporation constitutes a contribution to capital and not an expense of carrying on the business of the individual. *Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943).

If the transfer for the benefit of the corporation made by a stockholder was of some property other than cash or stock of the corporation for whose benefit the transfer was made, we would undoubtedly hold that such transfer was a contribution to the capital of the corporation. I can see no reason why a different result should be reached because the property used by a stockholder for the benefit of the corporation is the stock of the corporation for whose benefit the transfer was made. I therefore agree with the conclusion of the Circuit Court in *Schleppy v. Commissioner*, *supra*, although I respectfully disagree with the interpretation placed by that court on our opinion in *Foster v. Commissioner*, 9 T.C. 930 (1947).

Since, clearly, the transfer of the stock by petitioner in this case was for the benefit of the corporation, I would hold for respondent. Even though I consider our holdings

in the cases relied on by the majority to be incorrect, I would be hesitant to depart from holdings extending over a period of 50 years, except for the fact that respondent's regulation, which the majority has declared invalid, fairly puts taxpayers on notice that transfers of stock for the benefit of the issuing corporation might now be considered contributions to capital.

I would accept respondent's regulation, not because of any specific statement in section 83 of the Code which supports it, but because it is now and has been, despite our decisions to the contrary, a proper interpretation of the result of a transaction such as is here involved.

I have no problem with the situation of a stockholder transferring stock to a third party for the benefit of the issuing corporation where the transfer is for a sum that results in a gain to the transferor. To the extent the transferring stockholder receives consideration other than a benefit to the corporation from his transfer of stock, he has received a gain in the amount of the difference in the monetary consideration received and his basis in the stock transferred. This is true even though the transfer may be at less than the fair market value of the stock. This situation can be equated with a bargain sale of stock to a relative. We have held that a taxpayer in such a situation has made a gift of the value of the stock in excess of the bargain price at which it is transferred even though that bargain price was greater than his basis in the stock. In such a situation, we have held that there is both a taxable gain and a gift. If stock is transferred at less than its value but more than its basis for the benefit of the issuing corporation, instead of a gift, a taxpayer would have made a contribution to the capital of the corporation of the excess of the value of the stock over the price received for it. He would have a taxable gain and also would have made a contribution to the capital of the corporation. This is not to be interpreted as determining whether a contribution to capital under these

circumstances would increase the taxpayer's basis in his remaining stock. This is a separate issue that is not involved in the instant case.

DAWSON and CHABOT, *JJ.*, agree with this dissenting opinion.

SIMPSON, *J.*, dissenting: Usually, when we have a vexing question of statutory interpretation, we are faced with a problem not anticipated during the development of the legislation, and we are unable to ascertain the treatment which Congress would have intended if it had considered the matter. Not so in this case. Here, the legislative purpose is indisputable, and the regulations undertake to carry out that purpose. The majority quibbles with the way Congress undertook to express its purpose, and because it did not set forth all the intended rules in the statute itself, the majority proposes to disregard the clearly manifested legislative purpose.

When Congress decided to legislate with respect to the tax treatment of bargain sales of property to persons rendering services, it recognized that in addition to sales by an employer to an employee, it needed to provide rules broad enough to cover other compensatory sales of property. Thus, section 83(a), which governs the taxability of the recipient of the property, applies "If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed." Thus, the rule applies to any compensatory transfer, not merely to a transfer to an employee. It includes a sale made by a parent or shareholder of the employer corporation to an employee of such corporation. For example, in the case of a group of affiliated corporations, the parent corporation may wish to retain all of the stock of the subsidiaries so that employees of the subsidiaries are offered an opportunity to purchase, at a bargain, the stock of the parent.

Though the primary purpose of section 83 was to provide rules for determining when the recipient of the bargain realized compensation and was taxable thereon, Congress recognized that questions would arise as to whether and when a deduction for compensation is to be allowed. See *Deputy v. du Pont*, 308 U.S. 488 (1940); *Hewett v. Commissioner*, 47 T.C. 483 (1967); *Rand v. Commissioner*, 35 T.C. 956 (1961). As a result, it enacted section 83(h), which accomplishes two objectives: it allows a deduction under section 162 to the person for whom the services are performed, and it allows such a deduction when the compensation is includable in income. By describing the recipient of the deduction as "the person for whom were performed the services," it is clear that Congress had in mind situations where the transferor would be a person other than the employer; there would have been no need to use such convoluted language if Congress had meant merely to cover a bargain sale by an employer to an employee. The committee report reinforces that view. S. Rept. 91-552 (1969), 1969-3 C.B. 423, 500-502.

In deciding whether a deduction is to be allowable in such situation, and to whom, the draftsmen no doubt had in mind the various views of the transaction that could be taken: when a shareholder sells his stock to an employee of the corporation, it could be viewed as a simple sale (*Downer v. Commissioner*, 48 T.C. 86 (1967)); under that view, there would be a capital transaction giving rise to gain or loss, but there would be no transfer of compensation taxable to the employee and deductible by either the transferor or the employer. *Deputy v. du Pont*, *supra*. In the alternative, the transaction could be viewed as a transfer of stock to the corporation and a transfer of such stock by the corporation to the employee. Since the statute allows a deduction for compensation, the statute makes clear that Congress rejected the view that the transaction was merely a sale by a shareholder to an employee.

Having decided to tax the employee on the receipt of compensation and to allow the corporation a deduction for the payment thereof, the draftsmen went on to explain in the committee report the theory on which such treatment was based; that is, the parent or shareholder is considered to have made a contribution to the capital of the corporation. The draftsmen could have expanded the provisions of section 83(h) and included in the statute rules reflecting the treatment of the transaction described in the committee report.<sup>1</sup> Surely, we cannot have any doubt that Congress would have passed the legislation had the statutory provisions been expanded in that manner, and surely, we can have no doubt that the statements of the committee reported accurately reflect the legislative purpose. See, for example, *United States v. Davis*, 397 U.S. 308-312 (1970), in which the Supreme Court relied on legislative history to decide the scope of the "not essentially equivalent to a dividend" provision of section 302(b)(1), and *Walt Disney Productions v. United States*, 480 F.2d 66, 68-69 (9th Cir. 1973), cert. denied 415 U.S. 934 (1974), in which the court relied on legislative history to decide what was "tangible personal property" for purposes of the investment credit.

In *Downer v. Commissioner*, *supra*, we adopted a different view of the transaction, but since the decision in that case, Congress has reviewed the subject and adopted section 83(h) reflecting its view of the transaction. In taxing the employee on the compensation and in allowing the corporation a deduction for compensation, Con-

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<sup>1</sup> Sec. 83 was enacted as a part of the Tax Reform Act of 1969, Pub. L. 91-172, 83 Stat. 588. Although such legislation was a major tax bill, it was considered and enacted by the Congress in a single calendar year—hearings on tax reform were announced by the Ways and Means Committee on Jan. 29, 1969, and the legislation was finally approved by the Congress on Dec. 22, 1969. In hindsight, it is easy for us to say that the draftsmen should have expanded the statutory provisions, but their failure to do so may be understandable in the light of the time pressures upon them.

gress rejected the view that there was simply a sale by the shareholder to the employee. Under such circumstances, we are no longer bound by our decision in *Downer*, and we should accept and apply the clearly expressed legislative purpose.<sup>2</sup>

FAY, WILBER, and CHABOT, *JJ.*, agree with this dissenting opinion.

## APPENDIX C

Section 83(a) GENERAL RULE.—If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property, shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

(b) ELECTION TO INCLUDE IN GROSS INCOME IN YEAR OF TRANSFER.—

(1) IN GENERAL.—Any person who performs services in connection with which property is transferred to any person may elect to include in his gross income, for the taxable year in which such property is transferred, the excess of—

(A) the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), over



(B) the amount (if any) paid for such property.

If such election is made, subsection (a) shall not apply with respect to the transfer of such property, and if such property is subsequently forfeited, no deduction shall be allowed in respect of such forfeiture.

(2) ELECTION.—An election under paragraph (1) with respect to any transfer of property shall be made in such manner as the Secretary prescribes and shall be made not later than 30 days after the date of such transfer. Such election may not be revoked except with the consent of the Secretary.

(c) SPECIAL RULES.—For purposes of this section—

(1) SUBSTANTIAL RISK OF FORFEITURE.—The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

(2) TRANSFERABILITY OF PROPERTY.—The rights of a person in property are transferable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.

(3) SALES WHICH MAY GIVE RISE TO SUIT UNDER SECTION 16(b) OF THE SECURITIES EXCHANGE ACT OF 1934.—So long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in such property are—

(A) subject to a substantial risk of forfeiture, and

(B) not transferable.

(d) CERTAIN RESTRICTIONS WHICH WILL NEVER LAPSE.—

(1) VALUATION.—In the case of property subject to a restriction which by its terms will never lapse, and which allows the transferee to sell such property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property unless established to the contrary by the Secretary, and the burden of proof shall be on the Secretary with respect to such value.

(2) CANCELLATION.—If, in the case of property subject to a restriction which by its terms will never lapse, the restriction is cancelled, then, unless the taxpayer establishes—

(A) that such cancellation was not compensatory, and

(B) that the person, if any, who would be allowed a deduction if the cancellation were treated as compensatory, will treat the transaction as not compensatory, as evidenced in such manner as the Secretary shall prescribe by regulations,

the excess of the fair market value of the property (computed without regard to the restrictions) at the time of cancellation over the sum of—

(C) the fair market value of such property (computed by taking the restriction into account) immediately before the cancellation, and

(D) the amount, if any, paid for the cancellation,

shall be treated as compensation for the taxable year in which such cancellation occurs.

(e) APPLICABILITY OF SECTION.—This section shall not apply to—

- (1) a transaction to which section 421 applies,
- (2) a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2),
- (3) the transfer of an option without a readily ascertainable fair market value, or
- (4) the transfer of property pursuant to the exercise of an option with a readily ascertainable fair market value at the date of grant.

(f) **HOLDING PERIOD.**—In determining the period for which the taxpayer has held property to which subsection (a) applies, there shall be included only the period beginning at the first time his rights in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier.

(g) **CERTAIN EXCHANGES.**—If property to which subsection (a) applies is exchanged for property subject to restrictions and conditions substantially similar to those to which the property given in such exchange was subject, and if section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applied to such exchange, or if such exchange was pursuant to the exercise of a conversion privilege—

- (1) such exchange shall be disregarded for purposes of subsection (a), and
- (2) the property received shall be treated as property to which subsection (a) applies.

(h) **DEDUCTION BY EMPLOYER.**—In the case of a transfer of property to which this section applies or a cancellation of a restriction described in subsection (d), there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection

(a), (b), or (d) (2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

(i) **TRANSITION RULES.**—This section shall apply to property transferred after June 30, 1969, except that this section shall not apply to property transferred—

(1) pursuant to a binding written contract entered into before April 22, 1969,

(2) upon the exercise of an option granted before April 22, 1969,

(3) before May 1, 1970, pursuant to a written plan adopted and approved before July 1, 1969,

(4) before January 1, 1973, upon the exercise of an option granted pursuant to a binding written contract entered into before April 22, 1969, between a corporation and the transferor requiring the transferor to grant options to employees of such corporation (or a subsidiary of such corporation) to purchase a determinable number of shares of stock of such corporation, but only if the transferee was an employee of such corporation (or a subsidiary of such corporation) on or before April 22, 1969, or

(5) in exchange for (or pursuant to the exercise of a conversion privilege contained in) property transferred before July 1, 1969, or for property to which this section does not apply (by reason of paragraphs (1), (2), (3), or (4)), if section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies, or if gain or loss is not otherwise required to be recognized upon the exercise of such conversion privilege, and if the property received in such exchange is subject to restrictions and

conditions substantially similar to those to which the property given in such exchange was subject.

Section 1001(c) RECOGNITION OF GAIN OR LOSS.—Except as otherwise provided in this subtitle, the entire amount of the gain or loss, determined under this section, on the sale or exchange of property shall be recognized.

Treasury Regulation § 1.83-6(d) *Special rules for transfers by shareholders*—(1) *Transfers*. If a shareholder of a corporation transfers property to an employee of such corporation or to an independent contractor (or to a beneficiary thereof), in consideration of services performed for the corporation, the transaction shall be considered to be a contribution of such property to the capital of such corporation by the shareholder, and immediately thereafter a transfer of such property by the corporation to the employee or independent contractor under paragraphs (a) and (b) of this section. For purposes of this (1), such a transfer will be considered to be in consideration for services performed for the corporation if either the property transferred is substantially nonvested at the time of transfer or an amount is includible in the gross income of the employee or independent contractor at the time of transfer under § 1.83-1(a)(1) or § 1.83-2(a). In the case of such a transfer, any money or other property paid to the shareholder for such stock shall be considered to be paid to the corporation and transferred immediately thereafter by the corporation to the shareholder as a distribution to which section 302 applies.

(2) *Forfeiture*. If, following a transaction described in paragraph (d)(1) of this section, the transferred property is forfeited to the shareholder, paragraph (c) of this section shall apply both with respect to the shareholder and with respect to the corporation. In addition, the corporation shall, in the taxable year of forfeiture be allowed a loss (or realize a gain) to offset any gain (or loss) realized under paragraph (b) of this section. For example, if a shareholder transfers property to an em-

ployee of the corporation as compensation, and as a result the shareholder's basis of \$200x in such property is allocated to his stock in such corporation and such corporation recognizes a short-term capital gain of \$800x, and is allowed a deduction of \$1,000x on such transfer, upon a subsequent forfeiture of the property to the shareholder, the shareholder shall take \$200x into gross income, and the corporation shall take \$1,000x into gross income and be allowed a short-term capital loss of \$800x.

No. 83-299

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FILED

OCT 28 1983

ALEXANDER L. STEVAS,  
CLERK

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**In the Supreme Court of the United States**

OCTOBER TERM, 1983

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HENRY C. TILFORD, JR. AND  
BARBARA N. TILFORD, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

---

*ON PETITION FOR A WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS FOR  
THE SIXTH CIRCUIT*

---

**BRIEF FOR THE RESPONDENT IN OPPOSITION**

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REX E. LEE  
*Solicitor General*

GLENN L. ARCHER, JR.  
*Assistant Attorney General*

ALBERT G. LAUBER, JR.  
*Assistant to the Solicitor General*

JONATHAN S. COHEN  
KRISTINA HARRIGAN  
*Attorneys*

*Department of Justice  
Washington, D.C. 20530  
(202) 633-2217*

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### **QUESTION PRESENTED**

Section 1.83-6(d) of the Treasury Regulations provides that, if a shareholder of a corporation transfers stock to an employee of the corporation in consideration of the employee's performance of services for the corporation, the shareholder shall be considered to have made a contribution to the corporation's capital rather than a sale of the stock. The question presented is whether the court of appeals correctly upheld the validity of this Regulation.



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**BRIEF FOR THE RESPONDENT IN OPPOSITION**

---

## **OPINIONS BELOW**

The opinion of the court of appeals (Pet. App. 1a-10a) is reported at 705 F.2d 828. The opinion of the Tax Court (Pet. App. 14a-43a) is reported at 75 T.C. 134.

## **JURISDICTION**

The judgment of the court of appeals was entered on April 20, 1983. A petition for rehearing was denied on May 27, 1983 (Pet. App. 11a). The petition for a writ of certiorari was filed on August 23, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## **STATEMENT**

1. Petitioner Henry C. Tilford, Jr., was the principal officer of Watco, Inc. and, at the end of 1970, owned 100% of its issued shares (Pet. App. 2a). Watco lost money consistently. In order to induce well-qualified individuals to

work for Watco, petitioner entered into restricted stock agreements with current and prospective employees (Pet. App. 16a-21a). Under these agreements, which were substantially identical, petitioner transferred some of his Watco shares, in blocks of varying size, to key employees of the company. The size of each block depended on the employee's perceived importance to Watco; each block was "sold" at the nominal price of \$1, regardless of the number of shares transferred (Pet. App. 2a, 16a-21a). Each transfer was subject to a restriction giving petitioner the right of first refusal to repurchase the shares at book value if the employee left Watco (Pet. App. 2a, 16a). Watco continued to experience difficulties and the key employees gradually left the company; petitioner repurchased the stock from each departing employee, generally for \$1 per block (Pet. App. 19a-21a).

On his individual tax returns for 1971-1973, petitioner claimed losses from his sales of Watco stock to Watco employees, taking deductions of \$370,992, \$150,497 and \$159,246, respectively (Pet. App. 2a). Since petitioner sold each block of stock for \$1, these deductions approximated his basis in the shares transferred. The Commissioner disallowed these loss deductions, contending that petitioner's transfers of the restricted stock were transfers of property "in connection with the performance of services" and hence were governed by Section 83 of the Code<sup>1</sup> and its implementing regulations. Those regulations provide that "[i]f a shareholder of a corporation transfers property to an employee of such corporation \* \* \* in consideration of services performed for the corporation, the transaction shall be considered to be a contribution of such property to

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<sup>1</sup>Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended ("the Code" or "I.R.C.").

the capital of such corporation by the shareholder, and immediately thereafter a transfer of such property by the corporation to the employee \* \* \*." Treas. Reg. § 1.83-6(d)(1).

2. Petitioner sought redetermination of the Commissioner's proposed deficiencies in the Tax Court. That court, in a reviewed decision with six judges dissenting, invalidated Treas. Reg. § 1.83-6(d), holding that it was "outside the scope of the statutory provisions of [S]ection 83" (Pet. App. 28a). The court of appeals reversed, one judge dissenting. The majority held that the Regulation was "consistent with both the legislative history and statutory intent" of Section 83, as well as with this Court's decisions in *Deputy v. DuPont*, 308 U.S. 488 (1940), and *Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943). In the majority's view, those decisions stood for the proposition that "payments made by a stockholder for the benefit of his corporation are not deductible by the stockholder" (Pet. App. 4a-5a). The dissenting judge believed that the legislative history provided an inadequate basis for the Regulation, absent explicit language in Section 83 itself dealing with the treatment of shareholders in petitioner's position (Pet. App. 7a-10a).

#### ARGUMENT

The court of appeals correctly sustained the validity of Treas. Reg. § 1.83-6(d), which on its face denies petitioner the loss deductions he claimed. The Regulation represents a reasonable construction of Section 83 and is thoroughly consistent with — indeed, is grounded almost *verbatim* upon — the legislative history of that section. Petitioner does not allege (nor is there) a conflict among the circuits on this question. There is no basis for review by this Court.

1. This Court has consistently held that Treasury Regulations "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes" and "should not be

overruled except for weighty reasons." *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948). Accord, e.g., *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 533 n.11 (1979); *Bingler v. Johnson*, 394 U.S. 741, 750 (1969). Treasury Regulations, moreover, have "particular force" where they represent "a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent." *National Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472, 477 (1979). Accord, e.g., *Commissioner v. Tufts*, No. 81-1536 (May 2, 1983), slip op. 16 n.17.

2. Congress enacted Section 83 in 1969 in order to provide comprehensively for the tax treatment of property — particularly, restricted stock — that is transferred "in connection with the performance of services." Tax Reform Act of 1969, Pub. L. No. 91-172, § 321(a), 83 Stat. 588. Section 83(a) provides generally that the value of property transferred in connection with services "shall be included in the gross income of the person who performed such services" when the latter's rights become substantially vested, i.e., when the restrictions on his or her ownership lapse. Section 83(h) sets forth a parallel rule governing deductions by the employer. It provides that "there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal" to the amount included in the employee's income. Section 83(h) also provides that the employer's deduction shall be allowed in "the taxable year \* \* \* in which such amount is included in the gross income of the person who performed such services." Accordingly, as Judge Simpson noted in his Tax Court dissent (Pet. App. 41a), Section 83(h) accomplished two objectives. It clarified previous law by making a deduction available to *the employer*, regardless of who formally

transfers the stock. And it mandated that the employer take deductions *in the same taxable year* that the employee recognizes income.

Treasury Regulations interpreting Section 83 were published in proposed form in June 1971 (36 Fed. Reg. 10787) and in final form in July 1978 (T.D. 7554, 1978-2 C.B. 71); the regulations thus represent a "contemporaneous construction" of the statute.<sup>2</sup> Section 1.83-6 establishes general rules governing the allowance of a deduction to the employer. Section 1.83-6(d) sets forth a "[s]pecial rule[] for transfers by shareholders," providing that such a transfer, if made to an employee of the corporation in consideration of services performed for the corporation, shall be treated as a capital contribution by the shareholder to the corporation, followed by a transfer of the property by the corporation to the employee.

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<sup>2</sup>There is no merit to petitioner's contention (Pet. 6-7 n.2) that the regulations cannot properly be applied retroactively to his 1971-1973 tax years. Section 7805(b) provides that Treasury Regulations generally apply retroactively, leaving it up to the Commissioner's discretion to "prescribe the extent, if any, to which any . . . regulation . . . shall be applied without retroactive effect." The regulations were pending in proposed form when petitioner filed his tax returns for 1971-1973, and the proposed and final versions of Section 1.83-6(d) were substantially identical in treating transfers like petitioner's as capital contributions. Compare 36 Fed. Reg. 10793 (1971) with T.D. 7554, 1978-2 C.B. at 83. Thus, there is no basis for contending that the Commissioner here abused his discretion by "promulgat[ing] retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity" accorded them. Pet. 7 n.2, quoting *Chock Full O'Nuts Corp. v. United States*, 453 F.2d 300, 303 (2d Cir. 1971). The delay in promulgating the regulations in final form was due to the Treasury's decision to redraft certain sections in response to taxpayers' comments at the public hearing. T.D. 7554, 1978-2 C.B. at 72. Since the regulations were proposed promptly, this delay obviously does not make their construction of the statute any less "contemporaneous."

As the court of appeals properly held (Pet. App. 5a-7a), Treas. Reg. § 1.83-6(d) provides a reasonable interpretation of Section 83's operation in situations where restricted stock is transferred, not by the employing corporation, but by one of its shareholders. As noted above, Section 83(h) states that the employer is entitled to "a deduction under section 162" in such circumstances. Section 162, however, allows a business-expense deduction only for amounts "paid or incurred during the taxable year." If the compensatory transfer is nominally made by the shareholder, it is not obvious how the employer is entitled to a business-expense deduction, since the employer has not literally "paid or incurred" anything. Section 1.83-6(d) offers a logical explanation of how the employer's deduction arises in this situation, viz., by treating the shareholder's purported "sale" as a contribution to the corporation's capital, followed by a compensatory transfer by the corporation to the employee.

If there were any doubt that the challenged Regulation faithfully reflects Congress's understanding of how Section 83 was meant to operate, that doubt would be removed by the legislative history. The report of the Senate Finance Committee, which added Section 83(h) to the bill, explained (S. Rep. 91-552, 91st Cong., 1st Sess. 123-124 (1969)):

"In general, where a parent company's or a shareholder's stock is used to compensate employees under a restricted stock plan, the transfer of the stock by the parent company or shareholder is to be treated as a capital contribution to the company which is to be entitled to a deduction in accordance with the restricted property rules."

As petitioner concedes (Pet. 9), it cannot be doubted that Section 1.83-6(d) "is faithful to this language."



3. The challenged Regulation is likewise consistent with general tax principles. It is well established that the tax consequences of a transaction are determined by its substance, not by its form. *E.g.*, *Gregory v. Helvering*, 293 U.S. 465 (1935). And it is well established that a shareholder is not entitled to business-expense deductions for payments made for the benefit of his corporation, since such payments are incurred, not in his, but rather in his corporation's, trade or business. See *Deputy v. DuPont*, 308 U.S. 488, 493-494 (1940) (denying deduction to shareholder for expenses incurred in transferring incentive stock to corporate employees). Accord, *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593-594 (1943). Cf., *e.g.*, *United States v. Genesee*, 405 U.S. 93, 101 (1972) (bad debts); *Whipple v. Commissioner*, 373 U.S. 193, 202-203 (1963) (same). In the present case, petitioner's purported "sales" of stock to Watco's employees represented, in substance, compensation to them from Watco, the corporation for which they worked. Section 1.83-6(d) follows accepted tax principles by denying petitioner a loss deduction in these circumstances, and by recasting his "sales" as capital contributions so that the form of the transactions accords with their substance.<sup>3</sup>

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<sup>3</sup>Petitioner (Pet. 7-8) and the Tax Court majority (Pet. App. 28a) err in urging that the challenged Regulation conflicts with Section 1001(c) and its predecessors. That Section provides generally that, "[e]xcept as otherwise provided in [the Code], the entire amount of the gain or loss . . . on the sale or exchange of property shall be recognized." As Judge Simpson noted in his Tax Court dissent (Pet. App. 41a), however, Congress's decision in Section 83(h) to allow the employer a deduction for property transferred by a shareholder in connection with services makes clear that "Congress rejected the view that the transaction was merely a sale by [the] shareholder to [the] employee." Since petitioner's transfer was not, in substance, a "sale," Section 1001(c) has no application; its general rule must yield to the more specific provisions of Section 83.

4. The decision below is likewise consistent with the only other court of appeals decision that has considered an issue similar to that presented here. In *Schleppy v. Commissioner*, 601 F.2d 196, 198 (1979), rev'g 66 T.C. 622 (1976), the Fifth Circuit held that a shareholder's transfer of stock to his corporation to help improve its financial condition was a contribution to capital, not a "sale or exchange" capable of generating a tax-deductible loss. As noted below (Pet. App. 2a-3a, 6a-7a), Section 1.83-6(d) is strongly supported by the rationale of that decision, *i.e.*, that a shareholder is not entitled to a tax deduction when he transfers stock for the benefit of his corporation.<sup>4</sup>

5. Contrary to petitioner's contentions, therefore, Section 1.83-6(d) neither "is at odds with the plain language of the statute" (Pet. 10) nor "goes far beyond the plain language of section 83(h)" (Pet. 7). Rather, the Regulation simply makes explicit a mode of analysis that is necessarily implied by the operation of the statute Congress enacted. Petitioner seems to concede that statutes do not always "offer plenary solutions to the problems they address" and that regulations may permissibly "fill in the spaces that statutes do not reach" (Pet. 10). The Regulation at issue does just that.

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<sup>4</sup>The other cases cited by petitioner (Pet. 8) are for the most part Tax Court opinions that antedated this Court's decision in *Deputy v. DuPont*, *supra*, the Fifth Circuit's decision in *Schleppy*, and Congress's enactment of Section 83. To the extent those opinions conflict with the decision below, they are erroneous for the same reasons that the Tax Court majority was wrong here.

**CONCLUSION**

The petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE  
*Solicitor General*

GLENN L. ARCHER, JR.  
*Assistant Attorney General*

ALBERT G. LAUBER, JR.  
*Assistant to the Solicitor General*

JONATHAN S. COHEN  
KRISTINA HARRIGAN  
*Attorneys*

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